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FINANCING

WILL SOCIAL SECURITY BE THERE WHEN I'M READY TO RETIRE?

How the program is financed to pay benefits now and in the future

PURPOSE

To help the students understand how the Social Security system is financed to pay benefits now and in the future.

OVERVIEW

This lesson explains how the Social Security system is structured to pay benefits in the short-term and the distant future under a variety of conditions. The impact of changes in birth and death rates on the system, the difference between private insurance and Social Security, and the conditions that impact on the future of Social Security are discussed.

OBJECTIVES

At the conclusion of this lesson, the students will be able to:

Explain how their Social Security taxes are determined.

Describe how Social Security is financed to pay benefits now and in the future.

MATERIALS

VIDEOTAPE
(If it has not already been shown.)

HANDOUTS (1-5)

FACTSHEET #l
How Social Security taxes are determined.

FACTSHEET #2
How Social Security is financed to pay benefits now and in the future.

FACTSHEET #3
Current Financing Issues

QUIZ

KEY TERMS

BOARD OF TRUSTEES
A six-member Board of Trustees annually reports to the Congress on the financial health of the trust funds both in the short and the long-term. The Board consists of the Secretary of the Treasury, the Secretary of Labor, the Secretary of Health and Human Services, the Commissioner of Social Security, and two public appointees who serve four-year terms.

EARNINGS BASE
The maximum amount of earnings subject to the Social Security tax.

FEDERAL INSURANCE CONTRIBUTIONS ACT (FICA)
The law that requires employees and their employers, to pay Social Security taxes on the worker's earnings.

RESERVES
The amount of money remaining in the trust funds at any given time after contributions have been credited and beneficiaries have been paid.

SELF-EMPLOYED
Those persons in business for themselves working on a for profit basis.

SELF-EMPLOYMENT CONTRIBUTIONS ACT (SECA)
The law that requires self-employed persons to pay Social Security taxes on their net earnings.

TRUST FUNDS
Special funds set aside for a purpose specified by law. The following trust funds are used to pay Social Security and Medicare benefits:

a. Old-Age and Survivors Insurance (OASI) — Holds contributions from workers, their employers, and self-employed to pay retirement and survivors benefits.

b. Disability Insurance (DI)— A portion of the Social Security taxes is placed in this trust fund to pay disability benefits.

c. Hospital Insurance (HI)— A portion of the Social Security taxes is placed in the Hospital Insurance trust fund to finance the hospital insurance part of Medicare (Part A) for beneficiaries 65 and over, or who have received disability benefits for two years or more.

d. Supplementary Medical Insurance (SMI)—The SMI trust fund finances Part B of Medicare which pays doctor bills and other medical bills not covered by Medicare's Part A. This trust fund is financed by monthly premiums from enrollees and federal general revenues.

INFLATION
The increase in the price of goods and services without regard to actual value.

FEDERAL DEFICIT
The amount by which the federal government's expenditures exceed its income.

FEDERAL BUDGET
The schedule of income and expenditures used to keep track of federal government operations.

BABY BOOMERS
People born between 1946 and 1964, a period of the highest birth rates in U.S. history.

LIQUIDATION
To turn investments into cash.

PAY-AS-YOU-GO
The term used to describe the method by which Social Security has operated to pay benefits, in which taxes on current workers are used to pay benefits to current beneficiaries with a small reserve to pay benefits when tax collections fell short.

PARTIAL RESERVES
Term used to describe the present level of Social Security reserves, in which the reserve is being built up to help pay future benefits.

FULL RESERVES
Term used to describe the level of reserves the law requires insurance companies to maintain in order to fund all obligations as they are incurred.

GENERAL REVENUES
Refers to nondesignated federal income, generally the income tax.

DEMOGRAPHIC
Refers to population changes and events.

OPENING
THE LESSON

State the objectives of the lesson.
Review the key terms.

Begin the lesson by determining if students were aware of where the money comes from to pay Social Security benefits prior to viewing the video. How many have ever held a job? Did they notice the deduction from their paycheck? In the video, were the band members initially reacting only to the Social Security deduction or to the total number of deductions? Why did they focus on the Social Security deduction? (Probably because they think of it as something for old people while the other taxes are something everybody pays. Also, dependents can generally get a refund of state and federal income taxes if they earn below a certain amount.) Be sure that the discussion notes that Social Security benefits are financed from taxes paid by employees, employers, and the self-employed.

DEVELOPING
THE LESSON

1. The class can examine a sample payslip noting the deductions for federal and state income tax and Social Security and Medicare taxes, distinguishing them from each other. Note that sometimes Social Security and Medicare taxes are identified as "FICA"—Federal Insurance Contributions Act.

HANDOUT 1

2. Explain that the current and future tax rates are established by the Congress based on anticipated program expenses. Explain that Social Security taxes are paid on earnings up to a certain maximum which increases with increases in average wages. This is called the earnings and benefit base. (Show how the earnings and benefit base has increased over the years using Handout #2.) Medicare taxes are also paid on earnings but (in 1994 and later) there is no upper limit on the amount of earnings subject to this tax. This chart shows the maximum amount of annual earnings subject to the Social Security tax each year (earnings and benefit base) and the percentage at which these earnings were taxed (tax rate).

FACTSHEET 1

HANDOUT 2

Note that the future tax rate is currently scheduled to remain the same. However, the earnings base will increase each year with increases in national wage levels. The result is that, as your wages increase, so does the amount of the Social Security tax you pay, even though you pay at the same rate.

3. Have students calculate the amount of Social Security tax they may expect to pay on the wages they expect to receive in their first jobs after leaving school. (Multiply tax rate by the amount of the annual wages they expect to earn to find out the annual Social Security tax they would pay. You may call your Social Security office for the current earnings base. (It's listed in the telephone directory.)

HANDOUT 2

4. Ask for a description of how Social Security handles the funds it receives, based on Factsheet #2.

FACTSHEET 2

Note that the way Social Security manages its funds is similar to private insurance companies, but there are differences. Ask students to describe the similarities and differences using Factsheet #2.

HANDOUT 3

As with private insurance companies, Social Security funds that are not used to pay benefits are not merely kept in a vault; they are invested, and earnings on investments are used to help pay benefits. The law requires Social Security funds to be invested in U.S. government securities similar to the savings bonds sold to the general public.

Private insurance companies are considered sufficiently financed if they have reserves to cover outstanding obligations at any given time. Social Security is considered sufficiently financed when its scheduled income will meet anticipated expenses into the foreseeable future. This is because, as a social insurance system, it relies on contributions from future earnings, while the private insurance plan cannot.

5. Ask students to describe the “pipeline” view of Social Security financing, with today’s workers paying taxes at one end and yesterday’s workers drawing benefits at the other. Remember, today’s workers will one day be at the receiving end of the pipeline.

In the middle of the pipeline are the Social Security trust funds financed by Social Security taxes. There are three of them; one for Old-Age and Survivors Insurance (OASI), another for Disability Insurance (DI), and another for Hospital Insurance (HI).

This method of financing is intended to maintain a balance between income and outgo of the program and to maintain a small reserve balance to meet temporary shortfalls in tax income. This is viewed as “pay-as-you-go” financing.

Ask students if they can think of any other concept that would describe the way the Social Security program works. (It has also been called a “compact between generations,” a social contract between the government and the people.) Can they think of another metaphor like the pipeline that describes the way the system works?

6. As we have stated, the Social Security trust funds serve as a mechanism to maintain a balance between income and outgo of the program and to hold accumulated balances.

Since the 1983 amendments which strengthened the financing of the program, Social Security has been operating under a “partial reserve” method of funding. Reserve funds are being built up not just to handle occasional shortfalls in annual income, but to help pay future benefits.

The baby boomers, the large number of people born between 1946 and 1964, will begin retiring around 2010.

Today, there are three workers for every beneficiary; by the year 2030, there will be two workers for every beneficiary.

Sometime early in the next century, benefit payments will exceed revenues, and Social Security will have to redeem its substantial holdings to meet its obligations when it has redeemed all its holdings. Social Security will need to increase the income into the trust funds to pay benefits to future beneficiaries or reduce program costs.

Policymakers within the Administration and Congress are studying how best to make changes in Social Security taxes and / or benefits to restore long-range financial balance. They hope to implement such changes long before a critical financial situation develops.

Ask students to calculate the year they will retire. Using Factsheet 3, discuss the role the deficit plays in Social Security's future. As long as the government continues to spend more than it takes in, people can legitimately ask where the government will get the money to pay off its obligations to Social Security. (You may also use the bibliography if you wish to discuss this issue in more depth. Call your Social Security office for current information on reserve levels.)

7. Ask if students know what government bonds are. (Certificates sold by the government promising to pay a specified interest on the purchase price of the certificate and to return the original purchase price or "principal" at a specified date in the future.) Note that selling such bonds is the way state and city governments and many corporations also raise money.

FACTSHEET 3

Ask them if they believe the Social Security system should invest in other than government bonds. Point out that many experts believe it would not be good public policy to invest in private markets. Social Security's billions of dollars in reserves would mean the government would control a large share of the nation's investment capital. (Factsheet 3)

CONCLUDING THE LESSON

Based on the information students have received so far (video, factsheet, class discussion), how do they feel about the issue of whether Social Security will be there for them when they retire? Discuss. Cite the following factors:

HANDOUT 5

Strong government commitment to Social Security—the program has been amended frequently to meet changing needs, e.g., the 1983 amendments.

Strong public support for the program—one out of six persons receives Social Security benefits. (Refer to the videotape. Note strong public reaction to the notion of abolishing Social Security.)

The growing number of older people is a political force supporting the program.

Growing financial strength of the system over the next two to three decades as reserves build up.

Universality of Social Security—Almost all countries around the world have Social Security programs. It is the most popular means of providing a basic level of protection to the elderly, to people with disabilities, and to the survivors of someone who has died.

The program has developed and evolved in the past and will undoubtedly continue to evolve in the future as society changes, but the basic structure will endure.

EXTENDING THE LESSON

FINANCING ISSUES FACING SOCIAL SECURITY

In break-out groups, have students discuss each of the following issues based on the information in the factsheets, decide on a position, and present the position to the class.

SHOULD SOCIAL SECURITY BE USED TO BALANCE THE BUDGET?

FACTSHEET 3

Refer to the factsheet and ask students if they think Social Security should be included in the federal budget. What is the impact on the budget? The trust funds? The economy?

The operations of the trust funds are excluded from the federal budget. However, the investment of Social Security reserves in government bonds is equivalent to lending the money to the rest of the federal government—where it is spent to help pay other government expenses. Studies indicate that unless the budget is balanced without taking into account annual Social Security revenues and expenditures, the trust fund build-up will not constitute a real reserve fund, and, in effect, will not be available to pay for future benefits.

SHOULD THE SOCIAL SECURITY ASSETS BE INVESTED IN OTHER THAN GOVERNMENT SECURITIES?

FACTSHEET 3

What would be the impact on the trust funds? On the economy?

IS SOCIAL SECURITY A “RIP-OFF” FOR YOUNG PEOPLE? ARE OLDER AMERICANS “MAKING A KILLING” OFF OF SOCIAL SECURITY AT THE EXPENSE OF THE YOUNG TAXPAYERS?

FACTSHEET 3

Refer to the factsheet for a discussion of the value of Social Security to younger people.

ALTERNATIVE EXERCISE

SOME FACTORS AFFECTING THE FUTURE OF SOCIAL SECURITY

The following list of economic and demographic factors if they occur would have an impact on Social Security financing. Have each student analyze the impact and suggest an appropriate remedial action. Use the completed exercise as a basis for class discussion.

Another way to use this exercise is to give the answer sheet to students and have them comment on the relative merits of the remedial actions taken.

LOWER BIRTH RATE

U.S. birth rate may drop to the current rate in several western European countries by the next century. (1.6 children per woman compared to 2.0 today.)

IMPACT: Fewer workers paying Social Security taxes to pay current benefits. Would deplete reserves faster.

POSSIBLE RESPONSE: Increase taxes; raise retirement ages.

LABOR FORCE GROWTH

Will fall to an annual rate of less than one percent in late 1990's and decline further after the turn of the century.

IMPACT: Slower growth in the number of workers paying taxes that support payment of benefits.

POSSIBLE RESPONSE: Increase taxes, raise retirement ages, increase immigration.

THE NUMBER OF WORKING WOMEN

Proportion of women working outside the home will continue to increase, although at a slower rate than in the past.

IMPACT: More workers paying taxes that support the payment of benefits and increase income into the trust funds.

Also, fewer women drawing benefits as "dependents" (for whom no additional taxes are paid by spouse).

POSSIBLE RESPONSE: Continue to promote equality of women in employment and earnings.

IMMIGRATION

The U.S. is expecting increased immigration over the next decade.

IMPACT: More workers paying taxes to support the payment of benefits and increase income into the trust funds.

POSSIBLE RESPONSE: Promote further increases in immigration to help offset effects of low fertility rates.

QUIZ / ANSWER SHEET — FINANCING

1.	A	6.	A
2.	B	7.	B
3.	B	8.	B
4.	A	9.	D
5.	C	10.	A